

Greater Trade Integration with the EU makes the ENC's more Vulnerable

Dimitris Kallioras and Anna Maria Pinna

Dimitris Kallioras is an Assistant Professor at the Department of Planning and Regional Development, University of Thessaly, Greece. Email: dkallior@uth.gr. Anna Maria Pinna is an Assistant Professor at the University of Cagliari and researcher at CRENoS. Email: ampinna@unica.it. The research on which this article is based was supported by the Project "Sharing Knowledge Assets: InterRegionally Cohesive Neighbourhoods" (SEARCH) within the 7th European Community Framework Programme FP7-SSH-2010.2.2-1 (266834) European Commission.

In 2004, the EU launched, the European Neighborhood Policy (ENP), a unified policy framework towards its neighboring countries (the ENC's), lying in the external EU periphery, aiming at strengthening prosperity, stability and security around its geo-political borders. However, in-depth empirical analysis provides clear-cut evidence that the size and composition of trade flows between the EU and the ENC's may be growing, but are not favourable for the ENC's when measuring their export diversification, both in terms of products and number of destinations. A condition which increases their exposure to heightened volatility in the international markets. These responses delivered provide valuable insight to both economic integration theory and policy-making.

Keywords: EU, ENP, integration, trade

Introduction

The paradigm of the European Communities indicates that the process of integration, although it does not stem solely from economic incentives, is realized, first and foremost, in the economic field, as economic integration¹ (Shams 2002). Economic integration denotes “a state of affairs or process which involves the amalgamation of separate economies into larger free trade regions” (El-Agraa 2011: 1).² Indeed, international trade³ is usually the first type of linkage between independent economic units (Cornett 1996), and one of the most expedient (economic) factors in pushing economies into integration (Paas and Tafenau 2008). Economic integration reduces the role of national borders as barriers to factor mobility, and is, further, reinforced (self-sustained process) by the reduction of trade costs. “Closed” borders distort market size (Niebuhr and Stiller 2002), whereas the removal of economic barriers generates (releases) a number of spatial dynamics linked to better access to foreign markets and import competition (Brühlhart et al. 2004).

Currently, the EU consists of 28 member states, having managed – after the end of the Cold War and the fall of the Iron Curtain – to almost match its politico-economic with its geographical boundaries. The recent EU enlargements, in particular, brought the borders of the EU to a set of countries in the East with historically less intensive economic relations. These countries have been part of the (former) Soviet Union and are characterized by lower development levels and significant institutional and structural differences. At the same time, in the Southern and Eastern rim of the Mediterranean Sea, the EU is faced with countries that are linked to individual EU countries through their colonial past. Both bordering areas, in the EU East and the EU South, have been gaining significance as they include emerging economies, energy suppliers or, simply, a large neighbouring market, which is crucial for the EU economy (Petrakos et al. 2015).

Therefore, in 2004 the EU launched, the European Neighbourhood Policy (ENP), a unified policy framework towards the EU neighbouring countries (the ENC), lying in the EU’s periphery (EC 2003, 2004, 2006, 2007a, 2007b, 2010 and 2011, *inter alia* just

¹ Of course, the process of economic integration requires not only an economic rationale but also a strong political will (Rodriguez-Pose 2002).

² With respect to economic integration, Maksimova (1976: 33) focuses on “the process of development of deep and stable relationships of the division of labor between national economies”. Holzman (1976: 59) argues that economic integration is “a situation in which the prices of all similar goods and similar factors are equalized”. Pelkmans (1984: 3) considers economic integration as “the elimination of economic frontiers between two or more economies”.

³ Trade refers to the actual exchange of goods and services (Farole 2013: 23).

one of these is enough). The ENP is aimed at strengthening prosperity, stability and security around the EU's geopolitical borders.⁴

Focusing on the economic aspect of the ENP and considering that international trade activity is the primary proxy for economic integration, discussing the level and quality of economic integration may translate to an assessment of the level and the type of the wider international relations between the EU and ENCs adding details to the understanding of their political relations. Should they increasingly develop in a symmetrical way, trade activity may pave the way for, even, more intense and more symmetric (economic) integration between the EU and the ENCs. In-depth empirical analysis provides, indeed, clear-cut responses with respect to the level and the type of trade integration between the EU and the ENCs. These responses provide valuable insight into both economic integration theory (i.e. identification of the theoretical schools that tend to be confirmed) and for policymaking (i.e. identification of policy implications). The article utilizes trade data derived from COMTRADE Database (UN), which cover the period 2000-10⁵ and refer to the national-sectoral level (2-digit SITC classification). The sectors included in the analysis belong to the primary and secondary sector of production and form six groups of activities, according to the intensity of the production factors used.⁶

The article proceeds as follows: The next section surveys the literature on the level and type of trade activity in conditions of economic integration. The third section provides an overview of the ENP framework. The fourth conducts the empirical analysis on the level and type of trade flows between the EU and the ENCs, within the ENP framework. The last section offers the conclusions.

The benefits of economic integration: a review of the literature

Neighbouring countries provide the easiest market access for the majority of tradable goods as trade costs are, *ceteris paribus*, lower over small distances (Leamer and

⁴ Currently, the ENP framework applies to Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine (Eastern ENCs) and to Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Occupied Palestinian Territory (Palestine), Syria and Tunisia (Southern ENCs).

⁵ The time-span considered allows studying trade dynamics during the ENP implementation. More than the global economic crisis, events at the national level following 2010 introduce elements in trade data dynamics which are out of scope of the discussion in the paper. Though we only provide a descriptive analysis it is crucial to keep elements of internal conflict, which influence production and trade, out of the analysis. There is no data for the Occupied Palestinian Territory. Croatia is not included in the analysis.

⁶ Particularly, on the basis of the Harmonized System (HS) classification (UNCTAD 1996), these groups are: HS1 (non-fuel primary commodities), HS2 (fuel primary commodities), HS3 (labor-intensive and resource-based commodities), HS4 (low skill-, low technology-, low capital- and low scale-intensive commodities), HS5 (medium skill-, medium technology-, medium capital- and medium scale-intensive commodities), and HS6 (high skill-, high technology-, high capital- and high scale-intensive commodities).

Levinsohn 1995, Evenett and Keller 2002). Furthermore, when one country is much richer than the other, proximity trade is mutually beneficial as the richer country usually offers a wide variety of goods of superior quality, while the poorer country usually offers lower prices and attractive productive locations (Venables and Limão 2002, Ago et al. 2006). Free trade agreements (FTAs) are strongly based on this argument. Doing away with national borders is meant to create larger economic spaces for exploiting economies of scale, thereby reducing production costs. This means that the level of trade activity among the counterparts involved in a FTA is expected to intensify over time (Myint 1958, Burke 1973, Krueger 1978). Yet, there is an open issue with respect to the effect of international trade – and the formation of FTAs, in particular – on the type of trade activity among the counterparts involved.

On the basis of the concept of absolute advantage, first mentioned by Smith (1776), the concept of comparative advantage (Torrens, 1815 and Ricardo 1817) refers to the ability of a country to produce a particular product at a lower opportunity cost over another country. In order to gain from international trade, countries are expected to export products for which their relative prices in an autarchy (i.e. no trade) situation are lower than other countries. Building on the concept of comparative advantage, the Heckscher-Ohlin-Samuelson (H-O-S) model predicts the patterns of trade on the basis of the factor endowments of trading countries: countries will export products that use their abundant and cheap factor(s) of production in order to gain from international trade. Overall, traditional theories of international trade indicate that gains from international trade should be greatest among countries with the greatest differences either in terms of opportunity costs or in terms of factor endowments. Hence, international trade should cause countries to export products distinctly different from the ones they import.⁷ This way, countries may reap the so-called static effects of international trade (Balassa 1961).

Besides the static effects generated for members of a FTA (especially for the developing ones), so-called dynamic effects may also accrue (Balassa 1961). This is because international trade can generate positive externalities and spillover effects by transmitting and disseminating technological progress, knowledge and ideas (Rivera-Batiz and Romer 1991, Coe and Helpman 1995, Coe et al. 1997). Yet, this may not be the case when trading counterparts are asymmetric in the sense that they exhibit

⁷ Therefore, on the basis of traditional trade theory, it has been suggested that developing countries (such as the vast majority of the ENCs) are likely to gain more forming a FTA with high-income countries (such as the vast majority of the EU countries) instead of forming a FTA with other developing countries (Venables 2003).

considerable differences in terms of endowments and level of technology (Grossman and Helpman 1991, Devereaux and Lapham 1994). This means that the positive impact of international trade is expected to be conditioned by the level of development as weak economies, which have a similar structure to their more advanced trade counterparts, may face intense competition. In other words, international trade might push some countries, especially within a FTA framework, to specialise in products with low added value (Young 1991, Rivera-Batiz and Xie 1993, Paci and Usai 2000).

In an imperfectly competitive economic environment, comparative advantage is said to be created rather than naturally given, favouring intra-industry trade (i.e. more trade occurs within sectors than between sectors) activity (Poon and Pandit 1996). This fact stresses that specialization is an essential parameter of international trade activity. In an open economy, specialization is related to the export base of an economy (Tiebout 1956). International trade allows for greater specialization – since domestic demand for some products can be satisfied, at least partially, by imports – allowing inherent and acquired comparative advantages to be exploited more intensively (Weinhold and Rauch 1999). Apparently, trading with more advanced partners, less advanced countries tend to develop (become locked into) an inter-industry (i.e. more trade occurs between sectors than within sectors) type of trade activity. This type of trade activity, which imposes a specific economic structure with specialization typically in labour- or resource-intensive economic activities, is the outcome of the inability of the less advanced (and, usually, peripheral) countries to compete (successfully) with their more advanced counterparts in the markets for capital-intensive and knowledge-intensive economic activities (Brühlhart and Elliott 1998). Less advanced economies, with weaker productive bases, a high share of sensitive, labour- and/or resource-intensive sectors and unfavourable geographic coordinates struggle during the process of integration to effectively redeploy their resources in order to gain from the opening of markets (Camagni 1992).⁸

The ENP Framework: an overview

The ENP is an EU external relations and trade policy tool offering the ENCs conditional preferential politico-economic relations – but not full membership (Tocci 2005,

⁸ Moreover, due to unequal exchange mechanisms (Baran 1957, Emmanuel 1969/1972, Amin 1974), as integration improves market access and raises incomes, the patterns of consumption and production change and imports increase disproportionately to exports. This has the tendency to produce structural trade deficits, which threaten the stability of the local currencies and contribute to fiscal imbalances.

Johansson-Nogués 2007). In contrast to the (rigid) Copenhagen criteria that characterized the EU (eastwards) enlargement policy,⁹ the ENP framework involves bilateral, tailor-made, agreements between the EU and each of the ENCs. In particular, within the ENP framework, the EU negotiates a bilateral 'association agenda' with each of the ENCs, setting out a roadmap for jointly-agreed priorities in terms of political, economic and institutional reforms (Cadier 2013). Subject to progress (compliance) with respect to the jointly-agreed priorities, the EU and each of the ENCs may sign an Association Agreement. Even though it is a distinct and separate process from EU enlargement (Emerson 2004, Browning and Joenniemi 2008, Schimmelfennig and Scholtz 2008), the ENP is modelled upon the EU enlargement policy. As a result, the partnerships established under the ENP framework entail an almost continuous deepening of relations with the EU, with deep and extensive forms of economic association (Monastiriotis et al. 2014).

The general principles and objectives (such as the consolidation of democracy, promotion of human rights, preservation of peace, eradication of poverty and enhancement of market economy) enshrined in the EU Treaties are the cornerstones of the ENP undertaking. In exchange for the approximation of EU standards and values, the EU offers ENCs a triad of incentives (Cadier 2013): the provision of financial support; the removal of tariff and non-tariff barriers to trade; and visa liberalization. With respect to the removal of tariff and non-tariff barriers, the EU started to pursue FTAs bilaterally with targeted economies in order to protect its markets and enhance its competitiveness. In this sense, FTAs represent the first step for the EU to implement Deep and Comprehensive Free Trade Agreements (DCFTAs) with the ENCs so as to deepen the substance of trade agreements, thus, bringing the ENCs closer to the Single Market (de Gucht 2011, Dreyer 2012).¹⁰ DCFTAs envisage not only the mutual lifting of trade barriers but also harmonization of economic laws and regulations (related to investment protection, public procurement and competition policy) with the *acquis communautaire* (Koopmann and Wilhelm 2010, Woolcock 2010)-conditions of "neighbourhood Europeanization" (Gawrich et al. 2010). This means that, even though the "membership anchor" is missing (Havlik et al. 2012), the ENCs may perceive the ENP framework as a first step in a long road that will end-up with full EU

⁹ I.e. political criterion: stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities; economic criterion: existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the Union; legislative criterion: acceptance of the *acquis communautaire* (Preston 1997).

¹⁰ Yet, up to now (i.e. year 2015), only Ukraine has signed a DCFTA with the EU.

membership. Such an expectation is partly justified by the historical record of EU formation which has managed to expand, in a series of enlargements, first southwards and then eastwards, and to integrate countries with different development levels and institutional endowments (Petrakos et al. 2015). Therefore, the assessment of the level and type of economic integration between the EU and the ENC's is highly relevant not only to the understanding of the economic linkages and development prospects of both areas, but also to the evolution of their political relations.

The level and the type of trade activity between the EU and the ENC's: an empirical analysis

Quantifying the amount and type of trade

EU-ENC trade activity grew significantly in the period 2000-10¹¹ (Table 1), even though a decrease is recorded in 2008-09, just after the eruption of the economic crisis. In 2000, the top-5 ENC's with the highest export shares (i.e. percentages of country exports to the EU in relation to the corresponding total ENC's exports) belonged to the ENC's South (Libya, Algeria, Israel, Morocco and Tunisia). The situation changed, to some extent, in 2010: Libya, Algeria and Israel retained the top 3 positions, however Ukraine and Azerbaijan managed to enter the top 5, displacing Morocco and Tunisia. Over time, the top 5 ENC's exhibiting the highest corresponding increases belonged to the ENC's East (Azerbaijan, Ukraine, Georgia, Moldova and Belarus). Taking a look at the imports to the ENC's from the EU, the situation was analogous. In 2000, the top 5 ENC's with the highest import shares belonged to the ENC's South (Libya, Egypt, Morocco, Tunisia and Algeria). In 2010 the top position no longer belonged to ENC's South but to Ukraine. Over time, the top 5 ENC's exhibiting the highest corresponding increases belonged, again, to the ENC's East: Azerbaijan, Belarus, Ukraine, Georgia and Moldova. Overall, the vast majority of trade activity referred to the ENC's South; yet the share of the ENC's East increased. These facts beg the empirical question whether such an increase in trade activity was related to the formation of FTAs, seeing that the EU still does not have action plans with some important trade partners such as Libya, Belarus and Algeria.

Comparing exports to imports, it turns out that the vast majority of the ENC's have a negative trade balance with their EU counterparts (Table 2). The Index of Trade

¹¹ Even though data are expressed in current prices, the temporal comparison is possible because, to a great extent, the effect of inflation is neutralized by the effect of the devaluation of the domestic currencies.

Balance¹² reveals that in the year 2000 only Libya, Algeria, Syria and Azerbaijan had a positive trade balance. In 2010, this was true for only Libya, Azerbaijan and Algeria, meaning that the ENCs with positive trade balance became even fewer. Over time, Libya together with Azerbaijan, Algeria and Israel were the countries that exhibited improvement in their trade balance figures. Nevertheless, Israel continued to have a negative trade balance, which is complement to its surplus with the US.

Throughout the period, asymmetry characterized trade activity between the EU and the ENCs (Table 2). The Index of Trade Asymmetry indicates that the sectoral composition of ENC exports to the EU was not corresponded to the sectoral composition of ENC imports from the EU. In particular, in 2010, only Israel, Tunisia, Syria, Libya and Georgia experienced (positively) symmetrical trade activity with respect to the EU. In addition, the trade activity between the ENCs and the EU was of inter-industry type (last columns of Table 2 with all countries except for Israel and Tunisia, the most clear measure on the distance between the production structure of the EU economies and the Neighbouring countries.

-----Insert Tables 1 - 2 around here-----

The sectoral composition of trade activity reveals the reason behind the negative trade balances that the vast majority of the ENCs experienced. The Index of Revealed Comparative Advantage¹³ confirms the picture of asymmetry that characterizes trade activity between the EU and the ENCs. In 2010, Algeria, Azerbaijan, Belarus, Egypt, Georgia, Libya and Syria all exhibited their highest revealed comparative advantage with respect to the EU in the primary fuel commodities sector (HS2).

Measuring trade diversification

Measuring the level of diversification in ENC trade structures provides information on the quality of trade exchanges. Export diversification is variously defined as the change

¹² The Index of Trade Balance, also called Index of Net Exports, is the difference, in value terms, between the exports and the imports of a country under consideration concerning trade activity with a specific partner country or the world, in general (Sullivan and Sheffrin, 2003). A positive balance (i.e. exports higher than imports) is, also, known as trade surplus, whereas a negative balance (i.e. imports greater than exports) is, also, known as trade deficit.

¹³ The Index of Revealed Comparative Advantage is expressed as the proportion of country under consideration exports' in a specific sector divided by the proportion of a partner country (or world) exports' in the same specific sector (Balassa 1965). When the index takes values greater than 1, a comparative advantage is "revealed". Otherwise, the country under consideration has a comparative disadvantage. Given the size this table is not published. Results are available upon request.

in the composition of a country's existing export product mix or export destination (Ali et al. 1991), or as the spread of production over many sectors (Berthelemy and Chauvin 2000). Poor countries have, on average, undiversified exports. As they grow, they diversify, then reconcentrate at higher income levels. Although the direction of causation between income and diversification is unclear, depending on the stage of development, there are various stylized facts which indicate that a higher concentration level is not necessarily associated with greater prospects of prosperity.¹⁴ By looking at the Aggregated Specialization Index¹⁵ which measures the level of sectorial concentration/diversification (Table 3), it is evident that, in 2010, the vast majority of the ENCs exhibited higher levels of concentration than in 2000, in terms of exports, to both the EU market, the BRICS, than to other alternative destinations. When discussing diversification the number and the weight of first export destinations also plays a crucial role. The idea is simple: if a country's flows are concentrated in a few destinations and, on top of this, only some sectors are considered, the vulnerability of the whole trading system increases. Analysis of the best export and import partners for each ENC (Table 4), reveals that a good number of ENCs, especially the Southern ones (i.e. Algeria, Egypt, Libya and Syria), mainly export primary fuel commodities to their main destination. The respective shares are around 80 percent. The eastern ENCs mainly export machinery or agricultural products. Middle Eastern ENCs and Israel have no predominant sector; it depends on the destination. In general, at world level, even when the first destination does not have a big share, in seven out of fifteen ENCs, the first exporting sector accounts for more than 50 percent of the country's total exports. When concentrating on the EU market, in eight out of 15 ENCs, the best exporting industry accounts for more than 80 percent of total exports. When such a sectorial concentration is recorded in the destination that receives the most exports, the presence of export differentiation to other destinations is of less importance. Since the 1950s, development and trade theories (in particular the Prebisch hypothesis) have stressed out how reliance on the export of raw materials creates detrimental conditions for the exporting countries for three main reasons: deteriorating terms of trade, excess volatility, and low productivity growth. Political and economic risks in concentrating exports in a few primary commodities have been

¹⁴ For a very recent discussed survey on why trade diversification determines better economic perspectives in the long run see the 2014 WTO report (pg. 160-164) whose focus is on the new cases of resource base economies in the global international markets.

¹⁵ The Aggregated Specialization Index is a modified Herfindahl Index for capturing a measure of industrial concentration. A value of approaching 0 indicates a high degree of export diversification. A value approaching 1 implies a high degree of specialization.

surveyed and discussed in the 2014 WTO report, who dedicates a section to the role of commodities in recent development strategies. Export dependence on a few products (whose price has strongly increased since 2000) can be successful under strict and tight conditions which include foresighted fiscal and monetary policies in order to avoid a quick depletion of trade revenues. Also when such conditions are put in place the Report values risks arising from heightened volatility in export price, increasing natural resource exporters' vulnerability to boom-bust cycles.

This discussion becomes more complicated when ownership contracts are taken into consideration. Energy production is dominated globally and controlled by non-competitive market forces. Concentration in these sectors can be favoured by foreign interests which enter the domestic market with their capital and technological ownership, creating conditions for revenue concentration and broad inequalities in the distribution of the gains from trade.¹⁶ Thus, the lack of diversification both when looking at the production side and destination countries mix, and at the trade imbalances, is alarming as concerns the success of the (trade component of the) ENP undertaking.

-----Insert Tables 4 - 5 around here-----

Conclusions

By means of an in-depth empirical analysis, this article provides clear-cut, empirically-based data on the level and type of economic integration between the EU and the ENCs, based on international trade activity within the ENP framework. It is evident that the gradual dismantling of economic borders within the ENP framework has allowed for the expansion of trade activity between the EU and the ENCs. In other words, this means that economic integration between the EU and the ENCs has been increasing over time. Yet, the ENCs are engaged in an asymmetric, inter-industry, type of trade activity with their more advanced EU counterparts, and face serious difficulties in restructuring and diversifying their production bases: for many of them the main one. This is the main factor behind the negative trade balances that the vast majority of

¹⁶ Other conjectures for why heavy dependence on primary products can inhibit growth emphasize bad governance and conflict. Tornell and Lane (1999), among many others, argued that deficient protection of property rights would lead, through a common-pool problem, to over-depletion of natural resources. In a series of papers, Collier and Hoeffler (2004, 2005) argued that natural resources can also provide a motive for armed rebellions and found, indeed, a statistical association between the importance of natural resources and the probability of internal conflicts.

ENCs have with respect to their EU counterparts. Thus, the trade component of the ENP does not seem to provide a solid stimulus for the process of “neighbourhood Europeanization”.

Furthermore, there is the strong dependence on primary and energy resources. Arezki and van der Ploeg (2007), and Gylfason (2008) review various political-economy mechanisms through which natural resources interact with institutional deficiencies to hamper growth: in the absence of well-defined property rights, natural resources introduce a common pool problem and elicit rapacious rent-seeking, detrimental for growth.

Resource abundance is also known to erode the critical ability of politicians to avoid myopic choices tending to keep bad policies in place.¹⁷

Overall, the findings of the article provide valuable insight into both (economic integration) theory and policymaking. The well-established EU ‘core-periphery’ spatial pattern seems to be ‘reproduced’ in the wider EU area, thus throwing into question traditional theories of international trade that indicate that gains from international trade should be greatest among countries with the greatest differences either in terms of opportunity costs or factor endowments. While on the increase, the inter-industry type of trade activity between the EU and the ENCs cannot generate a sustainable economic integration path, even though it provides an alternative for the employment of locally available skills).

Translating the findings of the article into policy action, the EU should consider how best to calibrate its conditions and trade concessions more finely to meet the highly specific domestic and trade circumstances of the ENCs (by and large, its least able bilateral partners). In particular, EU trade policies, incentives and supporting programs should encourage ENC trade activity with the structurally proximate, low- and medium-income, EU countries, as well as provide technical support to improve diversification in the ENCs’ productive bases. By doing so, the EU could maximise the potential of trade as a reform incentive, a cornerstone of the ENP framework.

17 For example, countries rich in natural resources have a tendency to borrow excessively, especially if resources fetch a high price on international markets. When the resource prices fall, they end up with internal financial crises that have dire consequences for economic growth. Also, easy revenues from natural resources are especially tempting in the eyes of politicians in urgent need of public support. For example, while a resource rich country like Norway decided to invest virtually all its oil revenues in foreign securities and set them aside in a pension fund for future use, Algeria’s Fund for the Regulation of Receipts (FRR) raises a number of issues. With petroleum and natural gas accounting for almost two-thirds of the government’s income, more than a third of GDP, and 90 percent of export earnings (as reported by Gylfason, 2008), the choice made has been to use rents for short-term political gains rather than for investment in productive capital.

In the short run, improving and speeding up the diversification process could be fostered by favouring the development of closely related sectors that benefit from present capabilities through the re-investment of natural resource rents. The process of building up governance structures designed to separate the management of resource wealth from short-term political pressures is also a fundamental step in promoting positive trade effects for the economies of the countries lying on the outskirts of Europe.

In the long run, policymakers need to take action aimed at further improving the quality of institutions in the ENCs in order to establish controls on the risk of rent-seeking behaviour by domestic governments, as well as domestic and foreign investors, especially in conjunction with ill-defined property rights, imperfect markets, and lax legal structures.

The slow reforms and the upheaval and tensions in the vast majority of the ENCs may have their roots in the difficulty of the ENCs to adapt their productive systems to the pressures of internationalisation and to deliver tangible welfare services to large and increasingly mobile populations. Definitely, the trade incentive (that is, the removal of tariff and non-tariff barriers) is not sufficient. Even though the ENCs may see the trade component of the ENP as a commitment to lock in to economic reforms, the absence of a real 'membership anchor' might induce them to perceive their asymmetric type of economic integration with the EU negatively (even though the aspiration for full membership may continue to exist). Thus, outlook for the viability of the ENP undertaking is uncertain, especially considering that there are countries¹⁸ that can offer the ENCs less asymmetrical – and more importantly, conditionality-free – conditions for economic integration.

REFERENCES

- Ago T., Isono I. and Tabuchi T. (2006), Locational disadvantage of the hub, *Annals of Regional Science*, 40: 819-848.
- Amin S. (1974) (ed.), *Accumulation on a world scale*, New York: Monthly Review Press.

¹⁸ Such as, among others, Brazil, Russia, India and China (the BRICs).

- Arezki and van der Ploeg (2007) , Can the natural resource curse be turned into a blessing? The role of trade policies and institutions”, IMF Working Paper No. 07/55.
- Balassa B. (1961) (ed.), *The theory of economic integration*, Homewood: R. D. Irwin.
- Baran P. (1957) (ed.), *The political economy of growth*, New York: Monthly Review Press.
- Browning C. S. and Joenniemi P. (2008), Geostrategies of the European Neighborhood Policy, *European Journal of International Relations*, 14(3): 519-551.
- Brühlhart M., Crozet M. and Koenig-Soubeyran P. (2004), Enlargement and the EU periphery: The impact of changing market potential, *The World Economy*, 27(6): 853–875.
- Brühlhart M. and Elliott R. (1998), Adjustment to the European Single Market: Inferences from intra-industry trade patterns, *Journal of Economic Studies*, 25:225-247.
- Burke J. D. (1973), The effects of economic integration on the geographic concentration of trade: A case study, *Tijdschrift voor Economische en Sociale Geografie*, 64(4): 258-269.
- Cadier D. (2013), Is the European Neighborhood Policy a substitute for enlargement? *LSE Special Report*, 18: 52-58.
- Camagni R. (1992), Development scenarios and policy guidelines for the lagging regions in the 90s, *Regional Studies*, 26(4): 361-374.
- Chalmers D., Davies G. and Monti G. (2010) (eds), *European Union law: Cases and materials*, Cambridge: Cambridge University Press.
- Coe D. T. and Helpman E. (1995), International R&D spillovers, *European Economic Review*, 39: 859-887.
- Coe D. T., Helpman E. and Hoffmaister A. (1997), North-South R&D spillovers, *Economic Journal*, 107: 134-149.
- Collier P., Hoeffler, A. (2004) “Greed and grievance in civil war”, in Oxford Economic Papers, Vol. 56, No. 4, pp. 563-595.
- Collier P., Hoeffler, A. (2005) “Resource rents, governance, and conflict”, in Journal of Conflict Resolution, Vol. 49, No. 4, pp. 625-633.
- Cornett A. P. (1996) (ed.), *The internationalization of economies: From regional to global orientation*, Copenhagen: DJØF-Publishers (in Danish).
- De Gucht K. (2011), <http://trade.ec.europa.eu/doclib/press/index.cfm?id=766>, (retrieved in May 2013).

- Deveraux M. B. and Lapham B. J. (1994), The stability of economic integration and endogenous growth, *Quarterly Journal of Economics*, 109(1): 299-305.
- Dreyer I. (2012), Trade policy in the EU's neighborhood: Ways forward for the Deep and Comprehensive Free Trade Agreements, *Notre Europe Study & Research*, 90.
- EC (2003), Wider Europe – Neighborhood: A new framework for relations with our Eastern and Southern neighbors, *COM 104 FINAL*, Brussels: Commission of the European Communities.
- EC (2004), European Neighborhood Policy Strategy Paper, *COM 373 FINAL*, Brussels: Commission of the European Communities.
- EC (2006), ENP – A path towards further economic integration, *COM 726 FINAL*, Brussels: Commission of the European Communities.
- EC (2007a), A Single Market for citizens, *COM 60 FINAL*, Brussels: Commission of the European Communities.
- EC (2007b), A strong Neighborhood Policy, *COM 774 FINAL*, Brussels: Commission of the European Communities.
- EC (2010), Taking stock of the European Neighborhood Policy, *COM 207 FINAL*, Brussels: Commission of the European Communities.
- EC (2011), A new Response to a changing Neighborhood: A review of European Neighborhood Policy, *COM 303 FINAL*, Brussels: Commission of the European Communities.
- El-Agraa A. M. (2011) (ed.), *European Union – Economics and policies*, Cambridge: Cambridge University Press.
- Emerson M. (2004), European Neighborhood Policy: Strategy or placebo? *CEPS Working Document*, 215.
- Emmanuel A. (1969/1972), *Unequal exchange: A study on the imperialism of trade*, New York: Monthly Review Press (translated by Pearce B.).
- Evenett S. J. and Keller W. (2002), On theories explaining the success of the gravity equation, *Journal of Political Economy*, 110: 281-316.
- Farole T. (2013), Introduction: The challenge of lagging regions in Farole T. (ed.), *The internal geography of trade: Lagging regions and global markets*, Washington D. C.: IBRD / World Bank.
- Gawrich A., Melnykovska I. and Schweickert R. (2010), Neighborhood Europeanization through ENP: The case of Ukraine, *Journal of Common Market Studies*, 48(5): 1209-1235.

- Grossman G. and Helpman E. (1991), Trade, knowledge spillovers and growth, *European Economic Review*, 35(2): 517-526.
- Grubel H. G. and Lloyd P. J. (1971), The empirical measurement of intra-industry trade, *Economic Record*, 47(4): 494-517.
- Gylfason T. (2008), Development and growth in mineral-rich countries, CEPR Discussion Paper No. 7031.
- Heckscher E. F. (1919/1991), The effect of foreign trade on the distribution of income, in Flam H. and Flanders M. J. (eds): *Heckscher-Ohlin trade theory*, Cambridge Mass.: MIT Press, 43-69.
- Jackson M. and Petrakos G. (2001), Industrial performance under transition: The impact of structure and geography, in Petrakos G. and Totev S. (eds): *The development of the Balkan Region*, Aldershot: Ashgate, 141-174.
- Johansson-Nogués E. (2007), The (non-)normative power EU and the European Neighbourhood Policy: An exceptional policy for an exceptional actor? *European Political Economy Review*, 7: 181-194.
- Koopmann G. and Wilhelm M. (2010), EU trade policy in the age of bilateralism, *Intereconomics*, 45(5): 305-312.
- Krueger A. O. (1978) (ed.), Foreign trade regimes and economic development: Liberalization attempts and consequences, Cambridge Mass.: Ballinger for the NBER.
- Leamer E. E. and Levinsohn J. (1995), International trade theory: The evidence, *NBER Working Paper*, 4940.
- Monastiriotis V., Kallioras D. and Petrakos G. (2014), The regional impact of EU association agreements: Lessons for the ENP from the CEE experience, *LSE 'Europe in Question' Discussion Paper Series*, 80/2014.
- Myint H. (1958), The classical theory of international trade and the underdeveloped countries, *Economic Journal*, 68(270): 317-337.
- Niebuhr A. and Stiller S. (2002), Integration effects in border regions: A survey of economic theory and empirical studies, *HWWA Discussion Paper*, 179.
- Ohlin B. (1933) (ed.), *Interregional and international trade*, Cambridge MA: Harvard University Press.
- Paas T. and Tafenau E. (2008), Regional integration and international trade clusters of the enlarged European Union, in Jones B. R. (ed.), *Europe at the crossroads*, New York: Nova Publishers, 67-89.

- Paci R. and Usai S. (2000), Technological enclaves and industrial districts: An analysis of the regional distribution of innovative activity in Europe, *Regional Studies*, 34(2): 97-114.
- Petrakos G., Tsiapa M. and Kallioras D. (2015), Regional inequalities in the ENP countries: The effects of growth and integration, *Environment and Planning C: Government and Policy*, forthcoming.
- Poon J. and Pandit K. (1996), The geographic structure of cross-national trade flows and region states, *Regional Studies*, 30(3): 273-285.
- Preston C. (1997) (ed.), *Enlargement and integration in the EU*, London and New York: Routledge.
- Prodi R. (2002), http://europa.eu/rapid/press-release_SPEECH-02-619_en.htm, (retrieved in May 2013).
- Ricardo D. (1817) (ed.), *On the principles of political economy and taxation*, London: John Murray.
- Rivera-Batiz L. A. and Romer P. M. (1991), Economic integration and endogenous growth, *Quarterly Journal of Economics*, 106: 531-556.
- Rivera-Batiz L. A. and Xie D. (1993), Integration among unequals, *Regional Science and Urban Economics*, 23: 337-354.
- Rodriguez-Pose A. (2002) (ed.), *The European Union: Economy, society and polity*, Oxford: Oxford University Press.
- Samuelson P. (1948), International trade and the equalization of factor prices, *Economic Journal*, 58: 163-184.
- Schimmelfennig F. and Scholtz H. (2008), EU democracy promotion in the European Neighborhood: Political conditionality, economic development and transnational exchange, *European Union Politics*, 9: 187-215.
- Shams R. (2002), Why do countries form regions? The political economy of regional integration, *HWWA Discussion Paper*, 169.
- Smith A. (1776) (ed.), *An inquiry into the nature and causes of the wealth of nations*, London: Strahan and Cadell.
- Sullivan A. and Sheffrin S. M. (2003) (eds), *Economics: Principles in action*, New Jersey: Pearson Prentice Hall.
- Tiebout C. M. (1956), Exports and regional economic growth, *Journal of Political Economy*, 64: 160-164.
- Tocci N. (2005), Does the ENP respond to the EU's post-enlargement challenges? *The International Spectator*, 1(2): 25-27.

- Torrens R. (1815) (ed.), *An essay on the external corn trade*, London: Hatchard.
- Tornell A. and Lane P. (1999) Are windfalls a curse? A non-representative agent model of the current account and fiscal policy, NBER Working Paper No. 4839.
- UN, COMTRADE database, <http://comtrade.un.org/db/>, (retrieved in May 2013).
- UNCTAD (1996), *Trade and development Report 1996*, New York and Geneva: UN.
- Venables A. J. (2003), Winners and losers from Regional Integration Agreements, *Economic Journal*, 113(490): 747-761.
- Venables A. J. and Limão N. (2002), Geographical disadvantage: A Heckscher-Ohlin-von Thünen model of international specialization, *Journal of International Economics*, 58: 239-263.
- Weinhold D. and Rauch J. E. (1999), Openness, specialization and productivity growth in less developed countries, *Canadian Journal of Economics*, 32: 1009-1027.
- Woolcock S. (2010), EU trade and investment policymaking after the Lisbon Treaty, *Intereconomics*, 45(1): 22-25.
- Young A. (1991), Learning by doing and the dynamics effects of international trade, *Quarterly Journal of Economics*, 106(2): 369-405.

APPENDIX

Table 1: Volume of exports and imports (millions USD; current prices) ENC and the EU volume of ENC exports and imports to and from the EU

	2000	2005	2010	2000	2005	2010
	Exports			Imports		
ALGERIA	11,554	20,211	27,341	5,655	12,969	20,423
ARMENIA	120	656	340	246	534	730
AZERBAIJAN	912	3,114	12,920	302	1,852	3,102
BELARUS	1,069	4,242	3,452	1,291	3,994	8,830
EGYPT	3,206	6,431	9,256	7,486	10,435	19,371
GEORGIA	216	345	733	336	834	1,525
ISRAEL	9,465	12,095	14,618	14,416	16,575	18,968
JORDAN	172	485	316	1,519	2,896	3,655
LEBANON	237	268	433	2,730	3,920	6,228
LIBYA	12,029	23,580	36,360	2,341	4,445	8,763
MOLDOVA	237	533	770	507	1,338	2,020
MOROCCO	5,552	n/a	10,050	7,138	n/a	17,833
PALESTINE	n/a	n/a	n/a	n/a	n/a	n/a
SYRIA	3,282	3,741	4,733	1,745	3,498	4,813
TUNISIA	5,098	8,459	12,574	6,724	9,843	14,603
UKRAINE	3,854	10,481	14,417	4,143	16,338	22,786

Sources: COMTRADE database / Authors' elaboration

Please insert a thicker vertical line between exports and imports

Table 2: Index of Trade Balance / Index of Trade Asymmetry / Index of Intra Industry Trade

	2000	2005	2010	2000	2005	2010	2000	2005	2010
	Index of Trade Balance			Index of Trade Asymmetry			Index of Intra Industry Trade		
ALGERIA	5,899	7,242	6,918	0.011	0.031	0.110	0.037	0.069	0.051
ARMENIA	-126	122	-390	0.801	0.252	0.146	0.459	0.244	0.202
AZERBAIJAN	610	1,262	9,818	-0.002	-0.011	-0.004	0.038	0.047	0.016
BELARUS	-222	248	-5,378	0.236	0.049	0.075	0.345	0.229	0.227
EGYPT	-4,280	-4,004	-10,115	0.109	0.130	0.178	0.201	0.260	0.248
GEORGIA	-120	-489	-792	0.750	0.551	0.595	0.350	0.273	0.348
ISRAEL	-4,951	-4,480	-4,350	0.885	0.915	0.748	0.664	0.668	0.625
JORDAN	-1,347	-2,411	-3,339	0.362	0.285	0.403	0.169	0.179	0.117
LEBANON	-2,493	-3,652	-5,795	0.106	0.316	0.142	0.115	0.117	0.117
LIBYA	9,688	19,135	27,597	0.412	0.560	0.619	0.053	0.066	0.087
MOLDOVA	-270	-805	-1,250	0.035	0.166	0.207	0.237	0.295	0.287
MOROCCO	-1,586	n/a	-7,783	0.323	n/a	0.273	0.307	n/a	0.287
PALESTINE	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
SYRIA	1,537	243	-80	0.180	0.531	0.657	0.067	0.195	0.234
TUNISIA	-1,626	-1,384	-2,029	0.371	0.547	0.718	0.409	0.493	0.505
UKRAINE	-289	-5,857	-8,369	0.179	0.094	0.236	0.339	0.267	0.330

Sources: COMTRADE database / Authors' elaboration

Table 3 Sectorial diversification (Herfindahl Index) in the World, EU and BRICS markets

	Exports			Imports		
	2000			2000		
	world market	EU market	BRICS market	world market	EU market	BRICS market
Algeria	0.47	0.57	0.26	0.07	0.07	0.08
Armenia	0.19	0.28	0.77	0.17	0.12	0.24
Azerbaijan	0.19	0.21	0.84	0.14	0.13	0.25
Belarus	0.13	0.13	0.12	0.05	0.05	0.12
Egypt	0.14	0.18	0.35	0.06	0.07	0.06
Georgia	0.34	0.14	0.19	0.17	0.17	0.26
Israel	0.10	0.06	0.09	0.06	0.06	0.08
Jordan	0.13	0.12	0.47	0.04	0.06	0.08
Lebanon	0.06	0.05	0.15	0.03	0.04	0.08
Libya	0.63	0.68	0.72	0.06	0.07	0.22
Moldova	0.13	0.16	0.23	0.05	0.05	0.17
Morocco	0.11	0.14	0.67	0.04	0.06	0.08
Syria	0.42	0.55	0.57	0.07	0.09	0.07
Tunisia	0.18	0.24	0.90	0.05	0.07	0.07
Ukraine	0.10	0.07	0.49	0.04	0.04	0.09
	2010			2010		
	world market	EU market	BRICS market	world market	EU market	BRICS market
	Algeria	0.56	0.65	0.46	0.07	0.07
Armenia	0.12	0.22	0.21	0.03	0.06	0.06
Azerbaijan	0.80	0.95	0.35	0.05	0.09	0.05
Belarus	0.11	0.40	0.09	0.10	0.10	0.23
Egypt	0.07	0.12	0.17	0.05	0.07	0.05
Georgia	0.08	0.14	0.12	0.05	0.09	0.06
Israel	0.09	0.06	0.12	0.04	0.06	0.05
Jordan	0.08	0.11	0.54	0.04	0.08	0.05
Lebanon	0.07	0.17	0.83	0.05	0.07	0.04
Libya	0.79	0.82	0.97	0.06	0.09	0.05
Moldova	0.07	0.09	0.09	0.04	0.05	0.09
Morocco	0.09	0.11	0.33	0.04	0.05	0.06
Syria	0.27	0.76	0.15	0.05	0.08	0.05
Tunisia	0.09	0.12	0.36	0.05	0.06	0.08
Ukraine	0.08	0.08	0.07	0.06	0.05	0.17

Table 4 Best sector in the ENC's' best export destination, years 1995 and 2010

World market						
		1995		2010		
	Best destination	Best sector in the best destination	Best sector share	Best destination	Best sector in the best destination	Best sector share
Algeria	Italy	Crude Petroleum and Natural Gas Production	75%	USA & P.Rico	Crude Petroleum and Natural Gas Production	74%
Armenia	Belgium & Luxem.	Other Manufacturing Industries	79%	Russia	Beverage industries	55%
Azerbaijan	Turkey	Manufacture of textiles	27%	Italy	Crude Petroleum and Natural Gas Production	99%
Belarus	Germany	Manufacture of industrial chemicals	29%	Russia	Food manufacturing	26%
Egypt	Italy	Crude Petroleum and Natural Gas Production	51%	Italy	Crude Petroleum and Natural Gas Production	34%
Georgia	Turkey	Iron and steel basic industries	82%	Turkey	Iron and steel basic industries	50%
Israel	USA & P.Rico	Other Manufacturing Industries	41%	USA & P.Rico	Other Manufacturing Industries	37%
Jordan	Iraq	Food manufacturing	72%	Iraq	Food manufacturing	17%
Lebanon	Saudi Arabia	Agriculture and livestock production	34%	Switzerland & Lic.	Non-ferrous metal basic industries	74%
Libya	Italy	Crude Petroleum and Natural Gas Production	81%	Italy	Crude Petroleum and Natural Gas Production	87%
Moldova	Russia	Beverage industries	40%	Russia	Agriculture and livestock production	24%
Morocco	France	Man. of wear. apparel, except footwear	39%	France	Manufacture of electrical machinery appar.	25%
Syria	Germany	Crude Petroleum and Natural Gas Production	87%	Germany	Crude Petroleum and Natural Gas Production	91%
Tunisia	France	Man. of wear. apparel, except footwear	55%	France	Manufacture of electrical machinery appar.	38%
Ukraine	Turkey	Iron and steel basic industries	38%	Russia	Manufacture of transport equipment	21%
EU market						
		1995		2010		
	Best destination	Best sector in the best destination	Best sector share	Best destination	Best sector in the best destination	Best sector share
Algeria	Italy	Crude Petroleum and Natural Gas Production	75%	Italy	Crude Petroleum and Natural Gas Production	91%
Armenia	Belgium & Luxem.	Other Manufacturing Industries	79%	Bulgaria	Metal Ore Mining	100%
Azerbaijan	Italy	Agriculture and livestock production	57%	Italy	Crude Petroleum and Natural Gas Production	99%
Belarus	Germany	Manufacture of industrial chemicals	29%	Netherlands	Petroleum refineries	98%
Egypt	Italy	Crude Petroleum and Natural Gas Production	51%	Italy	Crude Petroleum and Natural Gas Production	34%
Georgia	Italy	Iron and steel basic industries	59%	Bulgaria	Metal Ore Mining	92%
Israel	UK	Other Mining	15%	Belgium & Luxem.	Other Mining	40%
Jordan	Italy	Other Mining	29%	Italy	Non-ferrous metal basic industries	50%
Lebanon	France	Manufacture of wearing apparel, except footwear	31%	France	Manufacture of machinery except electrical	84%
Libya	Italy	Crude Petroleum and Natural Gas Production	81%	Italy	Crude Petroleum and Natural Gas Production	87%
Moldova	Romania	Food manufacturing	53%	Romania	Manufacture of electrical machinery appar.	34%
Morocco	France	Man. of wear. apparel, except footwear	39%	France	Manufacture of electrical machinery appar.	25%
Syria	Germany	Crude Petroleum and Natural Gas Production	87%	Germany	Crude Petroleum and Natural Gas Production	91%
Tunisia	France	Man. of wear. apparel, except footwear	55%	France	Manufacture of electrical machinery appar.	38%
Ukraine	Italy	Iron and steel basic industries	34%	Italy	Iron and steel basic industries	61%

